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# Korea, China and Japan: Their Trade with the World and Its Impact on New Asian Regionalism ASEAN+3

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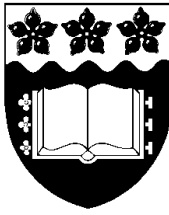
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**Korea, China and Japan:  
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**ABSTRACT**

Success of recent developments in Asian economic regionalism and free trade agreements depends to some significant extent on the continuing role and importance of trade of these economies with themselves and also with the world's major trading blocs. The paper reviews especially the case of Korea, Japan and China's interest in new Asian economic regionalism and FTAs, surveys particularly its important trends in international trade in the past 35 years and discusses how these trends and patterns will affect the Asian 3's growth and provide the background for more effective implementation of ASEAN+3 or even ASEAN+5 or similar bilateral, pluri-lateral and multilateral regional economic integrations in the long term.

## 1 Introduction

This paper is focused on the rising trend, heated discussions and growing support, at both the government and academic levels, in regional economic integrations in Asia. Special attention is paid to the case of Korea as a key player in these new developments. An analytical and methodological evaluation of the new Asian economic integration and free trade agreement or arrangement (namely ASEAN+3 or the 10 ASEAN countries plus China, Korea and Japan) is discussed and comments on its plausibility and viability and rival models from the international organisations (such as the International Monetary Fund (IMF)) are provided. We suggest that our cliometric methodological analysis and forecasting is useful to study ASEAN+3 policy issues and can be successfully extended to evaluative studies of other economic integrations and free trade arrangements in Asia, Oceania and other regions or trading blocs.

## 2 Genesis of the Expanded ASEAN

The ASEAN+3 proposal, also known as the Young-Ho Kim proposal, named after Korea's former Minister of Commerce who first put it forward, was first discussed in the mid 1990s. A number of factors can be attributed to its emergence. First, it was the result of decades of fast growth and a number of economic, financial and restructuring developments in North East Asia and in other major trading blocs in the world. Second, it was the result of developments and shifts in focus in North America and the European Union in the aftermath of the damaging Asia crisis starting in Thailand in July 1997 and its subsequent contagion to a number of 'once miracle' economies in East and South East Asia, the USSR, and to a lesser extent, North and South Americas and the European Union (EU). Third, it was the result of a benign neglect from such international organizations as the IMF or the economic power of North America and the EU on the plights of crisis countries in Asia and their lack of interest in seriously helping to solve the economic, financial and social problems arising from the Asia crisis.

In 2001 and early in 2002, other new developments in East and South East Asia (for example, the quick recovery and recurring growth in Korea and the continuing stagnant state of the world's second largest economy, namely Japan) gained prominence and gave rise to a number of new Asian economic integrations or regionalisms (NARs) and Asian FTAs.

These NARs and FTAs are currently indeed numerous and proliferating at an amazing speed at the behest of government leaders especially in the Asian region. They include, to name a few, ASEAN+3, ASEAN+5, ASEAN+5+Taiwan, Japan+Singapore, Japan+Korea, Japan+Mexico, Korea+Mexico+Chile, Singapore+New Zealand, China+Japan+Korea, Hong Kong+New Zealand, and last but not the least, Vietnam+US. There was currently even a discussion on the setting up of a North Asian FTA in which Japan will play an important part. As at 24 May 2002, a protocol was also being negotiated between Washington and Canberra to address key US complaints about the Australian market and to prepare for the setting up of a sweeping US-Australia FTA, as proposed by the Australian government (Peter Hartcher, 2002), to the dismay of New

Zealand which wanted on the other hand a trilateral US-CER (Closer Economic Relations between Australia and New Zealand). And on 26 May 2002, there was a suggestion by New Zealand Prime Minister Helen Clark to set up an Australia-New Zealand Economic Cooperation (ANZEC) to boost the low-activity 19-year old CER.

The main focus and objective of these NARs and Asian FTAs (as separate from currency unions) are to promote trade either among the Asian economies themselves or with the membership of other economies outside Asia such as the US, Mexico and Chile in the Americas, and Australia and New Zealand in the Oceania. Prominent among these NARs and Asian FTAs is the Young-Ho Kim proposal above (and part of it, the ASEAN+1 or ASEAN+China FTA) which has a 1,700 million people market, a USD2 trillion GDP, and USD1.2 trillion trade). ASEAN+China was endorsed by the 10 leaders of ASEAN in Brunei in November 2001 and its details were worked out at a negotiating meeting in Beijing in May 2002.

### **3 New Developments in NARs and FTAs in Asia**

Economic regionalism and FTAs are not new concepts in international trade and economic relations. The theoretical foundation of regional economic integration and trade arrangement (such as customs union and key concepts of trade creation and diversion), was expounded more than fifty years ago by such well-known economists as Viner and later Nobel Laureate Mundell. Their subsequent applications were adopted by many nations to setting up regional and preferential trade arrangements (RTA and PTA). The purpose of these arrangements was for assumedly mutual economic gains. It is this foundation and perceived benefits that eventually led to current debates on, for example, Bhagwati's dynamic path analysis and Krugman's study of the link between global welfare and the number of trading blocs, and studies on testable hypotheses on mutual economic gains. All those studies are based on variations of the computable general equilibrium (CGE) analysis, and on trade and investment liberalisation (an objective of the World Trade Organisation (WTO) and the Asia Pacific Economic Cooperation (APEC)) among trading nations.

It is within the concept of economic integration and using Whalley's six conditions for optimal trade arrangement and its subsequent welfare benefits that some authors at the APEF (Asia Pacific Economic Forum) conference organized by Kangwon National University in Seoul and Chunchon last May came to support a strong Asian FTA proposal such as the ASEAN+3 free trading bloc. This bloc is a FTA for 10 members of the ASEAN and the Asian 3: China, Japan and South Korea. This FTA is also justified on a number of empirical factors. These include (1) the expanded ASEAN's considerable diversities in size, (2) factor endowment, (3) economic structure, (4) trade orientation, (5) level of economic development, and (6) social-cultural background (see the conference papers and subsequent articles reported in *The Journal of the Korean Economy*, Vol. 2, No. 2, 2001).

Given these factors or characteristics of the ASEAN+3, what can bring or link, on the economic criterion alone, these widely different rich and poor, developed and developing economies together in this NAR?

It is interesting to note that the advocates at the conference cited foreign direct investment as the strong linkage between the ASEAN and the other Asian 3 (China, Japan and South Korea) and have proved the existence and implications of this linkage with ample data and their analysis. These advocates have also come to the conclusion regarding the viability of this FTA by noting that, individually or together, the 13 members of the ASEAN+3 possess comparative advantage in the world market. This advantage exists in both capital and technology intensive goods and in natural resource intensive products and labour intensive manufactured goods. Our reservations about the ASEAN+3 are given below in Section 5.

#### **4 Korea and the ASEAN+3**

Since its introduction, the ASEAN+3 concept and proposal have commanded wide attention and support of and also emulation by government leaders in a number of countries and regions especially in Asia (see above for a list of some recently proposed or discussed Asian or Asian-Oceania NARs and FTAs). Analysts region-wide have also shown great interest and provided an enormous amount of commentary.

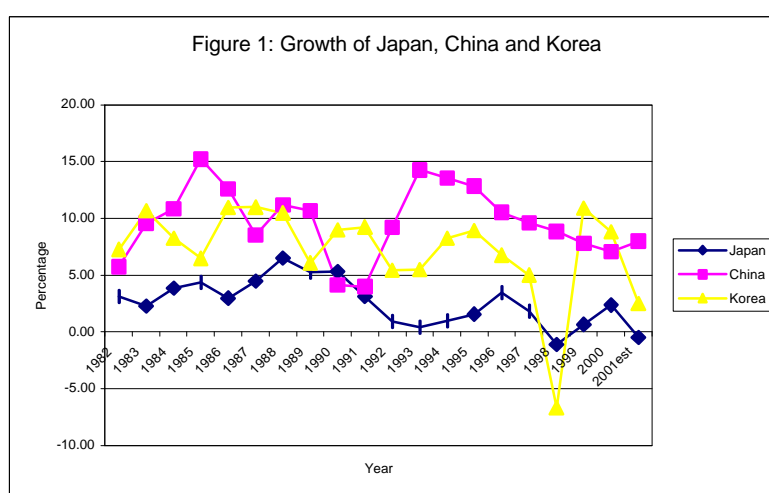
In the context of international economic relations in the face of major crises (for example, the Asia 1997 or the 11 September 2001 terrorist attacks in the US, this kind of popularity of the ASEAN+3 is understandable. Some reasons can be summarily given below.

For many pre-1997-crisis decades, major ASEAN economies as well as China and Korea had performed extremely well in their economic development and growth, in increasing economic power and influence, and in improving the living standard of their populations. Then came the Asia economic and financial turmoil of 1997 and its damaging consequences and contagion to the rest of Asia and beyond. It has been estimated by the World Bank and the Asian Development Bank that 200 million people have been made poor (not poorer) by this crisis (see Tran Van Hoa, 2000b). Governments had been toppled and the crisis countries' social order badly distorted as a result. At a conference at the London School of Economics and Political Science in October 2000, it was confirmed by participants (including IMF officials) that the responses of the international organizations to this crisis and its emerging problems had been slow and, worst still, they were inappropriate and ineffective for the crisis economies.

While a number of rescue policy initiatives were developed to deal with this ineffectiveness, these initiatives were held in abeyance or dropped as it was found in the late 1990s and early 2000s that the feared contagion of the Asia crisis to other parts of the world, especially, North America and the EU did not significantly eventuate. To some in Asia, the world in this case has lost interest in Asia and especially in major Asian

economies and their economic and financial problems and solutions even if this interest was sorely needed (see also Tran Van Hoa, 2001, and Tran Van Hoa, 2002a).

In this climate of benign neglect or outright indifference from the non-Asia regions, growth in China (which was not affected significantly by the Asia crisis) and Korea (which was badly affected by it) has strongly and positively rebounded and seems to have restored the successes of their pre-crisis economic development and growth. China had a growth rate of 8.84, 7.80, 7.05, 8.00 and 7.3 per cent respectively for the years 1997 to 2001, and Korea posted a rate of 5.01, -6.69, 10.89, 8.82 and 2.5 per cent respectively for the same period (ICSEAD, 2002). The same recovery cannot be said about Japan which has had a declining growth since the early 1990s with 2 weak rebounds in the mid- and late-1990s (see Figure 1). In 2001, Japan's growth was still negative at -0.05 per cent, according to the 2002 estimate of the ICSEAD. The begin neglect by non-Asia countries on Asia's problems and issues and the stronger than expected growth of China and Korea are the twin forces affecting, to a significant extent in our view, the proposals to set up various NARs and Asian FTAs in recent years.



Source: ICSEAD, 2002.

In addition to the factors above, the economic slowdown in North America and subsequently in the EU during 2001 and early in 2002 had caused concern not only to the Federal Reserve Board Chairman, Alan Greenspan, with his responses in announcing repeated cuts of interest rates (a simplistic one-instrument monetary solution according to many macroeconomic experts), but also to other countries' treasurers who also announced their similar interest rate cuts). The 11 September 2001 crisis and the crowding-out effect on resources of the coalition's war on international terrorism has not positively contributed to the health and growth of the economies of North America and the EU either. And this issues will remain so for a few years.

In contrast, in the first quarter of 2002, Korea's economy was reported to have grown faster than expected, due to record low interest rates and tax cuts that had fuelled a spending boom or consumption-led growth in the country. Asia's fourth largest economy expanded 5.7 per cent in the three months to 31 March 2002 from a year earlier (as reported by Korea's central bank). This was the fastest since the third quarter of 2000 and beat economists' expectations of a 5 per cent rise. In addition, Korea avoided the recession that struck neighbouring Japan, Hong Kong, Singapore and Taiwan in 2001, and was expected to outpace most of Asia again in 2002. The Bank of Korea expected growth of 5.7 per cent for the full year, almost double 2001's 2.5-3 per cent expansion (Seyoon Kim, 2002).

This combined effect of a declining growth of the US economy and the EU and strong growth in Korea and China again lends more support to the development and popularity of ASEAN+3 or even ASEAN+5 and other variations.

## **5 Challenges to NARs and Asian FTAs**

The creation of NARs and Asian FTAs (or more specifically ASEAN+3) seems to be amply justified on the reasons briefly described above. And, as a result, it has had the support of not only academics and economic analysts but also recent developments in major countries in Asia, North America and the EU. In our view however, these NARs and Asian FTAs are constrained, by virtue of the composition of their member countries, by their continuing historical and forecast patterns of international trade and traded-related growth and other non-economic factors.

Thus, in principle, we have sympathy for the creation of an expanded FTA such as the ASEAN+3. However, the very fact that the diversified nature of these 13 economies that has been used to justify the ASEAN+3 advocates' arguments may well be the real obstacle to this FTA. We therefore have some reservations and also suggestions about these integrations or regionalisms as amplified below.

First, the ASEAN+3, while including the world's second richest country and its most likely backer of reserves and emergency funds (namely, Japan), is on the other hand a real melting pot of more than 50 per cent of the world's population, embracing three of the world's great religions, having more than two-thirds of the world's income, and possessing histories that can be a few decades old (for example, Brunei and Singapore) or millennia old (China).

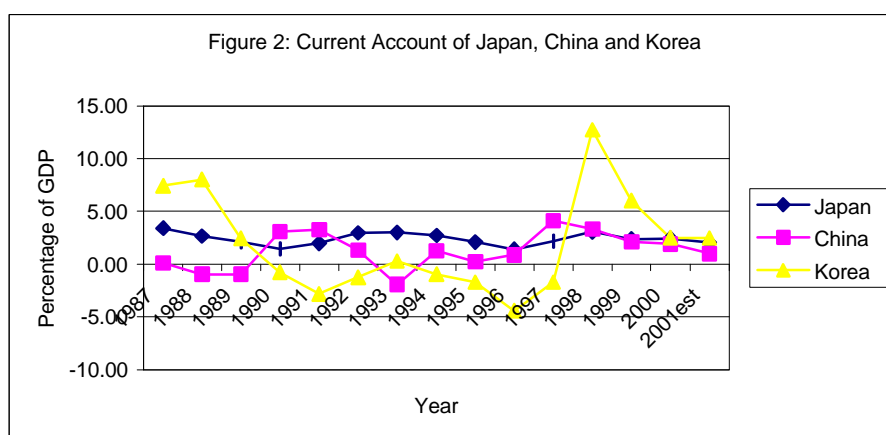
In a number of our recent books (Tran Van Hoa, 2001 and 2002a), it was reported that economic management policies of major ASEAN economies and Japan, while ostensibly Westernised in nature, have been nurtured and formulated more by these economies' traditions, histories and social construct and less by modern Western economic management theories. The outcomes of these influences are Japanese-style, Chinese-style, Singapore-style, Korean Japanese-style free markets or even a system of free-market with socialist orientation as in the case of Vietnam. If these are the outcomes of current economic management in the countries of ASEAN+3, the practical working of



this Asian FTA may have many more obstacles than its designers, supporters or policy-makers had in mind.

Second, while the current economic solidarity and collaboration among Asia's 3 largest economies are well documented, their rivalry or ultra-competitive relationship can go back to decades (1910-1945 in the case of Korea and Japan) or to centuries (in the case of China and other neighbouring countries). It is the lingering inheritance of this long-standing relationship or rivalry that sees Japan's present concern on the rise of China and Korea in world trade and development and may have some impact on the working of ASEAN+3 (see also Brendan Pearson, 2002).

Third, from an empirical context, the trends in international trade of the Asian 3 with the world's trading blocs do not seem to support in this case the strong viability of this FTA in the long term. In fact, the trends in current account of China, Japan and especially Korea (see Figure 2) had been declining faster and further after the 1997 Asia crisis. Also from Figure 2, Korea seems to have achieved growth at the expense of huge external debts through trade deficits or negative current account.



Source: ICSEAD, 2002.

Fourth, and perhaps more crucially, other fundamental economic issues of an expanded ASEAN one has to bear in mind are that the ASEAN and the Asian 3's bilateral trade have and will be more closely linked to North America and the EU. In this context, while ASEAN+3 member countries' trade both in volume and in share is crucial for its success, the shares of China, Japan and South Korea in ASEAN's imports had increased by about 10 per cent during the last 34 years, its exports were small compared to those of the US and the EU and, importantly, continually declining – from 46 per cent in 1967 to 34 per cent in 1999 for exports (see Figures 3 to 6). Also importantly, ASEAN's imports from the US and EU were mainly and crucially in hi-tech goods (see below) which were needed to support their trade (exports), growth and development.

From these figures, in 1999 for example, while ASEAN's exports to the US accounted for 35.0 per cent (USD75.7 billion and a rising trend since 1991 with 26.4 per cent) and to the EU 22.9 per cent (USD49.5 billion and a slight rising trend since 1995 with 20.9 per cent) of its total exports, ASEAN's exports to Japan reached only 19.9 per cent or USD42.9 billion (an almost continuous decline from 30.7 per cent in 1990), to Korea 5.3 per cent or USD11.4 billion (a fairly stable proportion from 1990), to enlarged China 10.0 per cent or USD21.7 billion (a fairly stable share from 1994), and importantly to the OPEC 4.4 per cent or USD9.5 billion (a falling trend since 1990), the fourth highest export market among the seven trading blocs for the ASEAN.

Also in 1999, while ASEAN's import shares from Japan, Korea and enlarged China accounted for, respectively, 30.5 per cent or USD51.9 billion (a decline from 36.3 per cent in 1994), 9.6 per cent or USD16.7 billion (a slight rise from 1997 with 8.5 per cent then) and 7.3 per cent or USD11.6 billion (an almost one per cent increase since 1994), the share to the US was still 21.5 per cent or USD36.5 billion, the EU 17.1 per cent or USD29.1 billion, and the OPEC 12.4 per cent or USD21.1 billion.

If these trends in ASEAN's exports and imports both by volume by share continue to the future by design or by need, there will be a real danger that the AESAN+3 will be dependent on the two markets of the US and the EU for the member countries' sustainable growth and not with its intra-trade. This will weaken the argument in support of a viable and sustainable ASEAN+3.

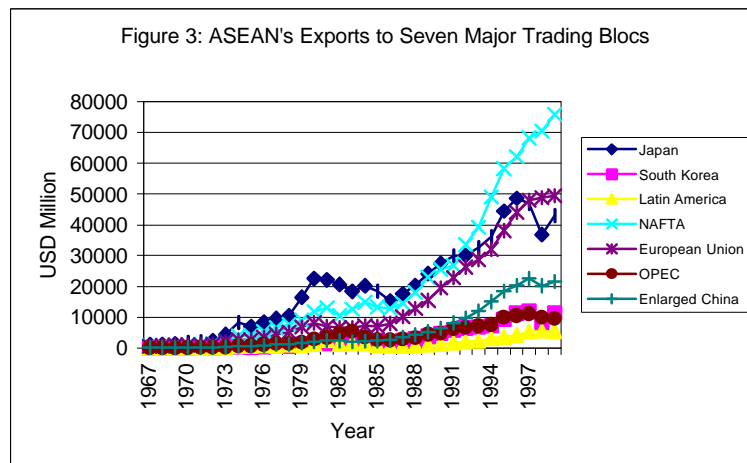


Figure 4: ASEAN's Exports to Seven Major Trading Blocs (Share)

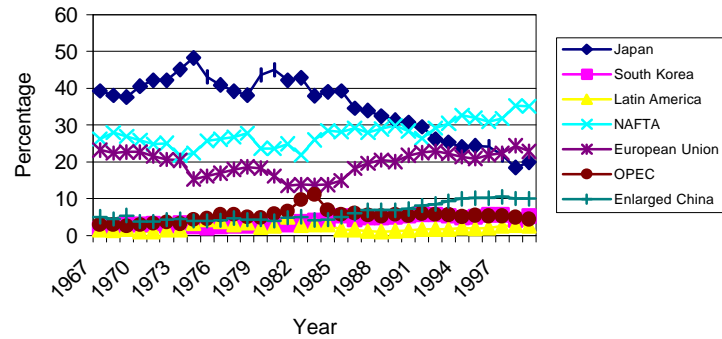
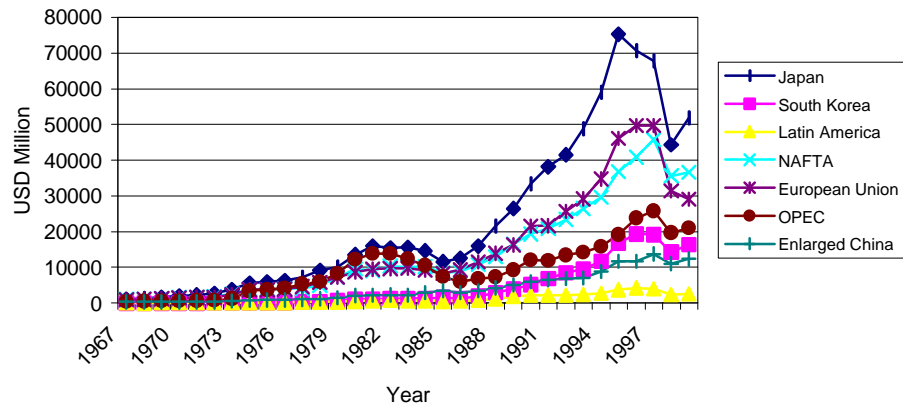
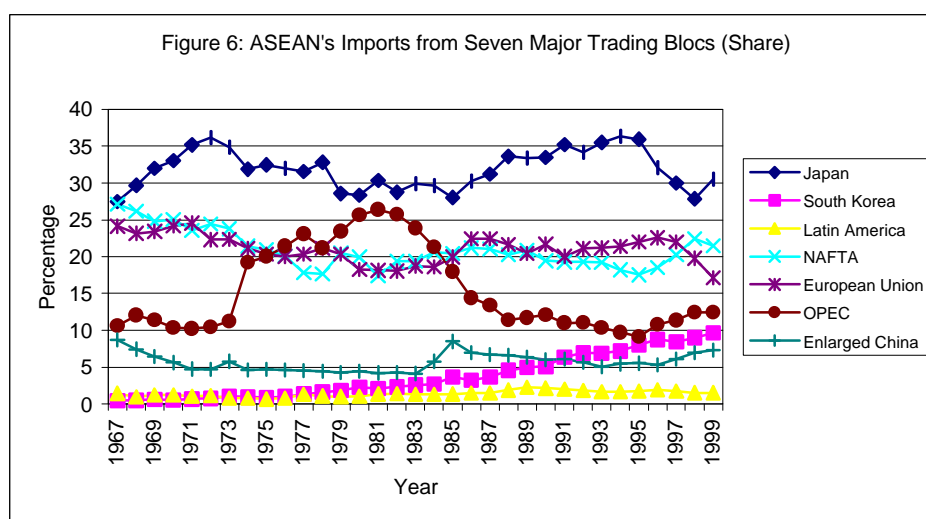


Figure 5: ASEAN's Imports from Seven Major Trading Blocs





Source: For Figures 3-6, 2001 CHELEM-CEPII database.

Fifth, in terms of trade and growth dependency, the ASEAN+3 issues become more serious when we note from our analysis of the trends of tradable commodities, based also on CHELEM-CEPII international trade data (see for example, Tran Van Hoa, 2000a), that ASEAN+3 trade with the US and the EU involves mainly commodities of a high-tech nature (e.g., metal products and chemicals). The implications are that to support their development and growth, the ASEAN+3 need new technology transfer from the US and the EU. This technology-transfer characteristics of ASEAN+3 trade will not be changed or be allowed to be changed by governments substantially in the foreseeable future especially in the face of increasing globalisation and international competitiveness (see Tran Van Hoa, 2002b).

Finally, with the current (as at May 2002) weakness of the US dollar on the world currency markets, the ASEAN+3 and the global economy would also have to face and embrace a tougher world export market. This should have important implications on the trends of international trade for the ASEAN as well as China, Korea and Japan in the months to come. This would further weaken the arguments in support of a viable and sustainable ASEAN+3.

## 6 Responses to the ASEAN+3 from the IMF

In view of the establishment of the ASEAN+3 (and other Asian FTA variations) and its inherent economic issues and problems, we may legitimately ask whether the structure or policies of some functions of the existing international organizations such as the APEC, the WTO or even the IMF can be amended or special divisions of them should be set up to accommodate the concerns and designs by the ASEAN+3 trade strategists and policy

makers in dealing with Asia's contemporary economic issues and problems. The perceived effect of this argument is that ASEAN+3 is not necessary, as some executives of the international organizations have advocated.

The reasons for this suggestion are that, first, to some, the emergence of the damaging Asia crisis in 1997 and its subsequent contagion were simply the outcome of a volatile international capital market that did not have proper prudential controls. Second, the impact of this crisis was still lingering, more than five years on, in Asia because the rescue and reform packages that were imposed by the IMF on the crisis economies were based on wrong diagnosis. As a result, wrong and ineffective prescriptions were recommended. It has been argued that this problem can be solved with more appropriate rescue policies by the IMF and, as a result, not by setting up an ASEAN+3 that may have the effect of diluting some of the functions of the IMF, the WTO or even the APEC.

The advocates of this solution suggest the setting up of a specialist division at the APEC, WTO or IMF, with a deep and proper understanding and expertise of Asian economies and societies in general and of ASEAN+3 aspects and issues in particular. To them, this solution may go a long way towards promoting economic growth and development and trade and investment in Asia itself and vis-à-vis the rest of the world.

## **7 Conclusions**

Above, we have briefly surveyed the rapid emergence of the ASEAN+3 and other variations of NARs and FTAs in Asia and Oceania in very recent months and the reasons which have been put forward to support them and the challenges or obstacles they possibly have to face and deal with for a successful implementation of these NARs and FTAs.

On the one hand, these arguments do seem to be reasonable responses to the legitimate needs of major Asian economies such as Korea, Japan and China, especially with their experiences from the 1997 Asia crisis and subsequent ineffective rescue policies from the IMF and also from the lack of interest from North America and the EU since early in 2000s. However, ASEAN+3 and their variations do have problems inherent in their member countries' economic, social and political make-up and ages-old ultra-competitive relationship and in their historical and future patterns of trade with the world's major trading blocs which continue to indicate the necessity of ASEAN's strong trade with North America and the EU and not the Asian 3 especially in hi-tech commodities.

On the other hand, the setting up of a special division of the IMF to handle Asian issues and problems may have a consistency in structure and function and may answer some concerns of the ASEAN+3 advocates. This solution would however be regarded by ASEAN+3 advocates especially from Korea as inadequate responses to future similar major economic or financial crises in ASEAN+3 countries as recent past experiences have clearly shown and, importantly, to the wishes of ASEAN+3 economies who have achieved spectacularly strong development and growth in the past decades. Recent

economic and financial crises are to them simply temporary setbacks with no random walk or permanent effects.

The whole development of Asian economic integration in its various bilateral, plural and multilateral forms including currency unions with the express purposes of trade liberalisation and welfare improvement for member countries needs further active research and discussions.

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